

Legal Regulation of the Crypto-Currency Taxation

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Abstract

At the beginning of the 21st century, we see the emergence of new legal relations related to the massive emergence of crypto-currencies. The natural question is, what to do with the taxation of the crypto-currency, new mining activity. We are analyzed different approaches in the world for this question. In the Republic of Belarus are created conditions for introduction in the economy of the technology of transaction block ledger (blockchain) and legally fixing such complex concepts as crypto currency, mining, digital sign (token). Granting tax holidays for 5 years gives, as advantages in attracting foreign business to the jurisdiction of Belarus, and can contribute to the inflow of illegal money, and therefore it is necessary to strengthen internal control to prevent the legalization of proceeds from crime, and to take an active part in global international initiative – the BEPS Plan (Base Erosion and Profit Shifting).

Keywords: taxation of crypto-currencies, mining, digital sign (token), blockchain.

1. Introduction

At the beginning of the 21st century, we see the emergence of new legal relations related to the revolution in the sphere of money circulation, changes in the world financial market and the ways in which business is conducted, the cause of which is the massive emergence of crypto-currencies. At present, there are more than 2000 crypto-currencies in the world, of which about 100 are known. The most popular ones are Bitcoin, Ethereum, Ripple, Litecoin, etc.

Among the experts of the world community, including lawyers, economists, financiers, there have been numerous discussions on the legal regulation of the crypto-currencies, the activities for their creation, mining, taxation, etc.

In this article, we will consider some aspects of the taxation of crypto-currencies, tokens and mining.

2. Discussion

The Decree of the President of the Republic of Belarus on 21 December 2017, No. 8 *On the development of the digital economy* (1) came into force on 28 March 2018 in the Republic of Belarus, in which the definitions of a crypto-currency, token, mining, were given for the first time. Thus, the Crypto-currency is a bitcoin, another digital sign (token) used in international circulation as a universal means of exchange.

Mining is an activity different from the creating of own digital signs (tokens), the aim of which is the maintaining of the functioning of the transaction block ledger (blockchain) by

means of the creating of new blocks with information about performed operations in such ledger. A person who carries out a mining process becomes the owner of digital signs (tokens) arisen (mined) as a result of his activity on mining and can get digital signs (tokens) as a reward for the verification of the operations executing in the transaction block ledger (blockchain).

- During last years the blockchain technology as well as different crypto-currencies were invented.
- Due to the fact that these technologies allow to transmit finances, the legal regulations of those are required.
- Several approaches to the concept of crypto-currency are defined in the world: property, assets, decentralized virtual currency, virtual goods, and property rights.
- Belarusian Decree No. 8 On the development of the digital economy proposes the cutting edge legal approaches for working with crypto-currencies.
- The key points in this sphere are: the international collaboration for the development of legislative initiatives and the joining of Belarus to the BEPS Plan.

Digital sign (token) is a record in the transaction block ledger (blockchain), or another distributed information system which verifies that the owner of a digital sign (token) has rights to civil-law objects and/or is a cryptocurrency.

Legal persons and individuals have the right to own tokens and, subject to the specifics established by Decree No. 8, perform a number of operations, for example, mining, storing tokens in virtual wallets, exchanging tokens for other tokens, their acquisition, alienation, etc. Legal persons are entitled to perform through a resident of the Park of High Technologies carrying out a respective activity, to create and place own tokens in the Republic of Belarus or abroad, to store tokens in virtual wallets, through cryptographic platform operators, cryptocurrency exchange operators, other residents of the Park of High Technologies carrying out a respective activity, to acquire, alienate tokens, to perform other transactions (operations) with them. Cryptographic platform operators, cryptocurrency exchange operators are obliged to ensure availability on accounts in the banks of the Republic of Belarus of monetary means in the amount of not less than 1 million Belarusian rubles for a cryptographic platform operator, not less than 200 thousand Belarusian rubles for a cryptocurrency exchange operator.

The activities on mining, acquisition, alienation of tokens, carried out by individuals independently without involving other individuals by labor and (or) civil-law contracts, is not entrepreneurial activity. Tokens are not the subject to declaration.

For purpose of accounting tokens arisen (generated) in the process of mining or acquired otherwise shall be recognized as assets. Placement by legal persons of tokens created by them leads to arising of obligations before the owners of those tokens. For purposes of taxation, alienation of tokens, including by means of their exchange for other tokens, shall be considered as realization of property rights.

In accordance with the clause 3 of the Decree No. 8, with respect to republican taxes, it was decided not to recognize the activities of mining, acquiring (including as a gift), alienation of tokens as objects of taxation until 1 January 2023.

Apart of the creation of crypto-currencies and their mining, the games based on the blocking technology, for example “CryptoKitties” based on the Ethereum platform, are becoming popular.

The essence of the game – the purchase and reproduction of cryptokitties, and their sale at auction. The cost of cryptokitties varies from 0.03 ETH (\$14) to 250 ETH (about \$117,000). The game “CryptoCelebrities” works roughly the same way: the system generates some cards, the user chooses the “contract” of what celebrity he wants to buy and makes the deal using Ethereum. Then the system generates a new, higher, price for the contract. Another user can buy out the celebrity card, and the contract owner can't refuse the deal. When the contract is sold, the player gets almost the entire amount; the system takes just a small fee. The more contract is being bought, the higher its cost. Currently the most expensive card is the card of the Ethereum creator,

programmer Vitaly Buterin, its cost is 24.5 ETH (\$25,000). It was bought for 31 times. The number of games like CryptoKitties will be only increasing in the future. Based on the Belarusian legislation, they are recognized as digital signs that are not the subject to taxation.

Let's consider the legislative approaches on the issues of the regulation of cryptocurrencies, mining and taxation in other countries.

In accordance with the Draft of Federal Law of the Russian Federation *On digital financial assets* (Ministry of Finance of Russia, 2018) cryptocurrencies, tokens refer to digital financial assets. Digital financial asset is a property in an electronic form, created with the use of cryptographic means. The ownership of this property is certified by adding digital entries to the digital transactions register. Digital financial assets are not a legal means of payment in the territory of the Russian Federation. Mining is an entrepreneurial activity aimed at the creating of a crypto-currency and/or validation in order to get a reward in the form of a crypto-currency.

Crypto-currency is a type of digital financial asset which is created and considered in the distributed registry of digital transactions by participants of the registry according to the rules of the maintaining of the registry of digital transactions.

Token is a type of a digital financial asset that is issued by a legal entity or an individual entrepreneur (hereinafter referred to as an issuer) in order to obtain financing and is recorded in the registry of digital records.

According to the latest explanation of the Russian Ministry of Finance in November 2017, the Tax Code of the Russian Federation does not provide any special procedure for taxing crypto-currencies and mining bitcoins. Thus, the income of an individual gotten from mining is taxed as a benefit in kind, i.e. at a standard rate of 13%. Russians should calculate the tax independently and submit a tax return to the tax declaration. Profit of a legal entity is calculated at a standard rate of 20%. The income in the form of a digital currency, received as a result of mining, is also a subject to taxation. A controversial issue is the taxation of the value added tax, because at the legislative level, digital money is not defined as a commodity.

As for Ukraine, the draft laws on the settlement of the crypto-currency market are at the stage of discussion. According to the Draft Law No. 7183 *On the circulation of the crypto currency in Ukraine* (Verkhovna Rada of Ukraine, 2018), crypto-currency is a program code (a set of symbols, numbers and letters) which is an object of ownership, which can be used as a barter, information about which is deposited and stored in the block system in the accounting units of the current block-system system in the form of data (program code).

Ukrainian lawmakers have followed the path of Canada and see operations with crypto-currencies equated to barter transactions with the application of the norms of civil legislation regulating the barter agreement. Mining is the computational operations executed by a miner with the help of own and/or leased specialized equipment, in order to ensure the operability and security of the blocking system. Depending on the conditions of the system, a miner receives a reward of the blocking system. The procedure for the taxation of crypto-currencies is planned to be provided for in the future by the Tax Code. Therefore, at present, standard rules of taxation apply to crypto-currency operations in Ukraine. The income of an individual gotten in the form of a digital currency is taxed at the standard rate of 18%, and the profit of legal entities depends on the tax system of specific legal entities. Also, as in Russia, the issue of paying value-added tax is controversial. Crypto-currency is not defined as a commodity at the legislative level.

In the United States, legal regulation of crypto-currency is limited. Starting from 2014, the Internal Revenue Service (IRS) has defined the crypto-currency as property, the transactions with which must be taxed (including mining) in accordance with the principles applied to property taxation. Thus, salaries paid to employees in the crypto-currency are subject to Federal Income Tax and Payroll Taxes. The tax base for wages in bitcoins is calculated on the basis of the rate of the crypto-currency at the date of a payment. Payments for services of a counterparty under a civil law contract in a digital currency are also taxed. US tax residents who sell goods and services in exchange for crypto currency are required to include the cost of the obtained bitcoins in the annual

tax return. It is calculated on the basis of a fair market price in US dollars at the date of the receipt (the exchange rate on that day) (Axon Partners, 2017).

The nature of the profit or loss from the sale or exchange of crypto-currency depends on whether the virtual currency is the main asset of the taxpayer. In accordance with the IRS clarifications, the crypto-currency is considered as a capital asset, similar to shares, bonds and other investment instruments, so the taxpayer is obliged to take profits and losses into account while calculating the taxable base. The profit arises in the case when the sale price in US dollars exceeds the adjusted purchase price. A loss arises when the sale price is lower than the adjusted purchase price. Mining is also a subject to taxation. Miner must include the fair market value of the extracted crypto-currency in his annual gross income.

The information about payments in the crypto currency must be submitted to the Tax Service (IRS). The incomes received by an individual in the crypto-currency, and other objects of taxation must be declared in dollars. Some penalties may be imposed to the residents who violated the tax laws. The control will be carried out on the basis of detailed accounting of all transactions with bitcoins. So, in December 2016, the Federal District Court of the Northern District of California authorized the Tax Service to request data on the bitcoin transactions of Coinbase users. Since January 1, 2018, a ban on tax evasion using crypto-currency is introduced, all transactions are subject to taxation (Axon Partners, 2017).

In Canada, the payment for goods or services using crypto-currency is taxed as a barter transaction. In the case of the sale of a digital currency, Income Tax, Corporation Income Tax or Capital Gains Tax are levied. Crypto-currency, obtained as a result of mining, which was carried out for commercial purposes, is subject to Income Tax. The definition of the commercial component is carried out in each case independently. The wages of an employee gotten in the crypto-currency are subject to taxation (The Eurasian Economic Commission, 2017).

The European Central Bank classifies crypto-currency (in particular, bitcoin) as a convertible decentralized virtual currency. In November 2015, the European Court of Justice decided that bitcoins serve no other purpose than payments, and that there is no VAT while buying or selling bitcoins (in Europe), despite the absence of the legal currency status. Other transactions may be taxed, for example, with income tax or capital gains tax. The procedure for taxation of crypto-currencies and their transactions is regulated by the national legislation of the EU members, depending on the nature of the crypto-currency operation (Axon Partners, 2017).

In Norway, the crypto-currency is subject to Capital Gains Tax at a rate of 24% and Wealth Tax, is exempt from VAT.

In Austria, the crypto-currency is considered by the tax authorities as an intangible asset, and its mining – as an operating activity. Therefore, the income received as a result of its alienation is subject to Income Tax.

In Sweden, the crypto-currency is subject to capital gains tax at a rate of 30%.

In Germany, since 2013, bitcoin is a kind of private money, the analogue of other investment instruments, such as stocks or bonds. As for taxation, a capital gains tax is withheld at a rate of 25%, and only if profits were received within one year after receiving bitcoins. In the case if the sale of bitcoins is carried out more than a year after the purchase, it will not be subject to a capital gains tax, and the transaction itself will be considered as a “private sale”.

In 2013, the Finnish tax authorities issued a special instruction for the taxation of the crypto-currency. Virtual currencies should not be considered “actual, official currencies”, while being the legal means of payment in the same time. The instruction gave two main approaches to taxation of income from operations with crypto-currencies, depending on the type of activity. When making investment or exchange transactions, income and expenses were regarded as an increase or decrease of the capital. In this case, the cost of obtained bitcoins was equated to their price on the exchange at the time of acquisition. At the same time, losses from such activities were not to be attributed to expenses in the tax declaration.

When a taxpayer received bitcoins as the income from mining, the tax authorities expected to charge coins as ordinary incomes. The price of coins was determined at the current

exchange rate. Companies selling goods and services for bitcoins or other crypto-currencies had to pay income taxes based on stock quotes on the day they got coins. If the price on the exchange was not available (if the coin was not yet traded on the exchange), then the price agreed by counterparties in the documents for purchase and sale was accepted. The fees in the crypto-currency could be attributed to the expenses in the declaration (Forklog, 2018)

In November 2014, almost a year before the relevant decision of the European Court, the Finnish regulators recognized bitcoin as a financial service, which is not given the legal status of a currency, and is exempt from VAT.

As for UK lawmaking practice, in 2014 Her Majesty's Revenue and Customs (HMRC) published a policy paper on the taxation of operations with crypto-currency. In accordance with it, the income obtained as a result of the mining of digital money (tokens) and their exchange into the pound sterling or another currency, should not be taxed with the VAT. But VAT must be levied on suppliers of any goods or services sold for crypto-currency. The cost of goods or services subject to VAT should correspond to the value of the crypto currency in pounds sterling at the time of such an operation. Depending on the situation, the income (profit) of the business entity is subject to Capital Gains Tax, Corporate Tax and Income Tax (Axon Partners, 2017).

In Switzerland, the crypto-currency is an asset, not securities. Operations with crypto-currencies do not require special permits (licenses), but some activities, including the purchase and sale of crypto-currency on a commercial basis and on existing trading platforms, may be subject to licensing. Also, the general requirements of the Swiss legislation for combating money-laundering apply to transactions with crypto-currencies.

In Japan in April 2017, crypto-currencies are officially recognized as legal means of payment. The concept of crypto-currency is separated from the concept of electronic money, crypto-currency is recognized not as a monetary means, but as a negotiable asset that can be used as a payment instrument. In this case, the operations for the exchange of crypto-currency for fiat money are not subject to the local analogue of VAT.

Crypto-currencies are equated to assets that can be used for payments and transmitted digitally. Receipts from operations with bitcoins, tokens are considered income from doing business and are taxed at the appropriate rates. The income gotten by an individual as a crypto-currency is subject to Income Tax, and the profit of a legal entity in digital currency is a corporate income tax.

The law of China does not contain special rules for the taxation of digital currency and transactions with it. Crypto-currency is defined as a virtual commodity, a non-monetary digital asset, but not a currency. Thus, the sale of digital money can be taxed with VAT, and income and profits in the crypto-currency are subject to Corporate Income Tax, Individual Income Tax and Capital Gains Tax. Since September 2017, there has been a ban on the public placement of crypto-currencies. At the same time in China, crypto-currency for individuals and crypto-currency transactions between them are allowed (Axon Partners, 2017).

In Singapore, crypto-currency is considered an asset, not a means of payment. In case of compliance with certain criteria they can be classified as securities. Operations with them may be subject to a local analogue of VAT. The very status of the crypto-currency is not regulated in details, but there is legal regulation of certain activities related to the circulation of crypto-currency. In particular, the Monetary Authority of Singapore (MAS) issued a number of regulatory documents governing the public offering of digital assets (tokens), as well as trade in them.

In October 2017, the UAE issued a basic guide to crypto-currencies and their public offering. Mining or spot transactions in virtual currencies are not a regulated activity in its own right. Any licensed companies that provide or use virtual currencies for financial services must adhere to existing anti-money laundering and terrorist financing laws.

Argentina is one of the leading countries in the use of crypto-currency, which is defined there as "the digital embodiment of value that can be used for e-commerce and whose functions are to form an exchange environment and/or a unit of account and/or value storage". In July 2014, the Department of Financial Information of Argentina (UIF), the authorized body for combating

money-laundering, issued a statement instructing all financial institutions performing operations with “bitcoins and other virtual currencies” to send information about such transactions to the UIF (KPMG, 2017).

In Australia, operations involving bitcoins and other crypto-currencies come under the definition of barter agreements. For tax purposes, bitcoin is considered an asset, not a payment instrument or a foreign currency. The income and profits received from transactions in digital currency are taxed with Income Tax and Corporate Tax. Companies performing transactions in bitcoins must properly document, record and indicate the dates of operations. Companies receiving bitcoins in the form of payments should indicate their value in Australian dollars and be treated as ordinary income. Operations with bitcoins for personal purposes are exempt from taxation when bitcoin is used as payment for goods and services for personal consumption, and when the transaction size does not exceed 10,000 Australian dollars.

The production of bitcoins and exchange for commercial purposes in Australia are considered exchange trades and are taxed accordingly.

If the digital currency is used as an investment, there is no need to pay the Capital Gains Tax. In Australia, there is a legal opportunity to pay wages in the crypto-currency, but only with the mutual consent of the employer and the employee and the existence of a contract between them (The Eurasian Economic Commission, 2018)

In Hong Kong, bitcoins and crypto-currencies are defined as virtual goods, and the tax law does not contain special rules for taxing such transactions.

Thailand, Bangladesh, Ecuador, Vietnam and Bolivia went on the road to a total ban on the use of crypto-currency.

Thus, several approaches to the concept of crypto-currency are defined in the world: property, assets, decentralized virtual currency, virtual goods, property rights.

3. Conclusion

Based on the foregoing, it can be concluded that the Republic of Belarus has adopted a progressive approach, legally defining such complex concepts as crypto-currency, mining, digital sign (token). We believe that in the future it is necessary to differentiate more clearly the notions of “crypto-currency”, which will become a means of payment, tokens, including the results of games such as “cryptokitties” and other digital objects, for example, game gold, accounts, websites and etc. Accordingly, the income received from transactions with such objects, in certain conditions, will be subject to taxation.

Granting tax holidays for 5 years gives advantages in attracting foreign business to the jurisdiction of Belarus, and nevertheless can contribute to the inflow of illegal money, and therefore it is necessary to improve internal control to prevent the legalization of money obtained by criminal sources, and to take an active part in global international initiative – the BEPS Plan (Base Erosion and Profit Shifting). We believe that by 2023 it is expedient, based on the experience of the European Union, to free turnover, profit (income) from mining activities, creation, acquisition, alienation of tokens from value-added tax, otherwise apply general taxation approaches. The key points in this sphere are the international collaboration for the development of legislative initiatives and the joining to the BEPS Plan by all countries.

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